WRNewswire

An AALU Washington Report

Tuesday, 16 September 2014 WRN# **14.09.16**

The *WRNewswire* is created exclusively for AALU Members by insurance experts led by Steve Leimberg, Lawrence Brody and Linas Sudzius. The *WRNewswire* provides timely reports and commentary on tax and legal developments important to AALU members, clients and advisors, delivered to your inbox as they happen.

TOPIC: Court Dismisses Misrepresentation Claims Where Policy Owner Alleged Premiums Were Guaranteed By Insurer But Subsequently Raised

CITE: *C&C Family Trust, et al. v. AXA Equitable Life Ins. Co., et al.,* No. 14-CV-62 (N.D. GA Aug 28, 2014).

SUMMARY: A Georgia federal court recently ruled in favor of a carrier and a producer on fraud claims brought by a policy owner who sued because of an "unexpected" increase in annual premiums. The policy owner alleged that it was told that the annual premium and paid-up date on a universal life policy were "guaranteed" not to increase or change during the life of the policy. However, the court noted that the express language of the policy provided that both the "paid-up date" and annual premium were subject to modification. Relying on this language, the court dismissed the fraud claims.

BACKGROUND: Life insurance illustrations can at times be confusing to those outside the insurance industry. Understanding and properly explaining an illustration takes expertise gleaned from years of experience in the industry. It is not hard to see how prospective clients can be easily confused. For example, terms such as guaranteed illustrations and current illustrations, when not properly explained, can lead a client to be ultimately unsure of what *is* guaranteed and what is merely a *projection*. This very common problem is at the root of the instant case.

FACTS: In April 2005, a life insurance trust was established by Cynthia Cox-Ott and Claude Ott as part of their divorce settlement. The trust was created for the benefit of Cynthia and was funded by a life insurance policy insuring Claude's life and naming the trust as beneficiary.

In August 2005, the trust took out a flexible premium universal life insurance policy issued by Defendant AXA. The policy had a $4,000,000 death benefit and an annual premium of $88,000. Cynthia Cox-Ott alleged that before taking out the policy, she had several discussions with the producer, Armen Hovakimian (also a defendant), who showed her illustrations and projections that represented that the policy would be paid up

when Claude Ott (then 67) turned 83. Furthermore, during 2005 and 2006, Cox-Ott alleged that AXA represented that the paid-up date, death benefit and annual premium were guaranteed. These representations were allegedly made orally by Hovakimian and in written policy illustrations prepared by AXA.

The policy was delivered on February 16, 2006. Additionally, eight days after the policy was delivered, Cox-Ott discussed the policy with Hovakimian, at which time it is alleged he made the representations about guarantees. Based upon these assurances, the trust decided to keep the policy in force.

After paying the initial premium, the trust made annual payments of $88,000 to AXA. However, in 2012, the trust received an annual report showing different projections (including an increase in annual premiums and a different paid-up date) than those that were allegedly "guaranteed" by AXA and Hovakimian. Subsequently, the trust retained counsel and wrote to AXA to obtain clarity as to the paid-up date and annual premium projections.

AXA did not respond to inquiries from the attorney and the trust filed a complaint with the Georgie Insurance Commissioner. Two months later, the trust was informed by AXA that premium increases would be necessary to keep the policy in force.

Subsequently, the trust filed a lawsuit against AXA on the basis that AXA and the producer misrepresented the policy's "guaranteed" values and annualized premium outlays. The trust asserted three causes of action: (1) common law fraud; (2) negligent misrepresentation; and (3) equitable reformation of the policy.

AXA responded by filing a motion to dismiss for failure to state a claim.

RESULT: The court granted the motion dismissing all three causes of action asserted by the trust. In seeking to dismiss the trust's fraud claims, AXA argued that the claims failed because they: (1) were about future events (the annual premium over the life of the policy) and such statements are not actionable under Georgia law; (2) the policy's merger clause barred any claims based upon oral statements made by the producer; and (3) there was no justifiable reliance, because the policy documents unambiguously stated that the annual premium may not be sufficient to keep the policy in force.

Initially the court stated that under Georgia law a party alleging fraud in the inducement has two choices: (1) affirm the contract and sue for damages from the fraud or breach; or (2) rescind the contract and sue in tort for fraud. The court ruled that because the trust also sought a claim for reformation, it effectively affirmed the contract, leaving it with no alternative but to then sue for damages from the breach.

Since the policy contained a merger clause that precluded any unilateral modification of contract terms through evidence of pre-existing terms or representations which were not incorporated into the final policy documents, the trust could not assert it relied upon any prior representations regarding the annual premium outlay. This, unfortunately for the trust, limited its fraud claims to whether there were misrepresentations in the contract itself. The trustee could not claim to rely upon any oral statements made by the producer

prior to policy issuance, nor upon any policy illustrations purportedly showing "guaranteed" values, because they were not incorporated in the final policy documents.

Here, all of the alleged misrepresentations occurred *prior* to the issuance of the policy and were not included in the final policy documents. Indeed, the policy explicitly stated to the contrary, unambiguously permitting the insurer to modify the annual premium. Accordingly, the court held that when AXA raised the annual premium, it could not be perpetrating a fraud, since such increases were specifically permitted under the contract signed by the insured.

The court also relied upon this unambiguous language in ruling there was no justifiable reliance by the insured or policy owner. Because the policy explicitly and clearly stated annual premiums may be insufficient, and therefore subject to an increase (or decrease), it was unreasonable for the trust to rely upon any purported statements to the contrary made by the producer or AXA. The terms of the contract are controlling and specifically permitted the modification.

The court did not address the argument based on whether the alleged statements were future events since it held that the merger clause and lack of justifiable reliance barred the claims regardless.

Finally, the court also dismissed the reformation claim. Georgia law permits a court to reform a contract to make it express the true intentions of the parties if fraud, an accident or a mistake has prevented it from doing so. However, the court held that it would *not* draft a contract different than that which the parties agreed to.

Here, the trust did not allege that the policy failed to capture the parties' true intentions because of an accident or mistake. The trust alleged only that it failed to do so as a result of fraud. However, since the court previously ruled the trust's fraud claim failed as a matter of law, the court could not then reform the contract based upon allegations that it did not capture the parties' true intentions because of fraud.

RELEVANCE: Be very careful here: While the trust's fraud claims were dismissed based upon the express language in the policy, courts have routinely permitted similar fraud claims to proceed in the past—even in the face of similar policy language. Indeed, one could argue that, had the trust not asserted a reformation claim and decided instead to seek rescission of the contract, the trust's fraud claims may have survived the defendants' motion to dismiss. In other words, in a similar situation a "win" by the insurer and agent is far from certain.

Regardless of the seemingly positive outcome, the producer still had to incur the costs, expenses, adverse publicity, and aggravation of being sued by his client for fraudulent misrepresentation. This could all have been prevented, however, had the agent explained in detail the difference between projections and promises to the trust. For these reasons, it is of paramount importance that producers and agents be very clear about the difference between a policy's "projections" and a policy's guarantees.

Additionally, when making these distinctions to clients, it is equally as important for the agent to make and retain written contemporaneous notes or otherwise document what he

or she is telling a client throughout the process. When this is done, there can be little debate about what a client was "promised" or "guaranteed." In fact, had the agent here done so, litigation could have been most likely avoided.

***WRNewswire* #14.9.16 was written by James S. Bainbridge, Esquire of The Bainbridge Law Firm, LLC.**

DISCLAIMER

This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.

The AALU *WRNewswire* and *WRMarketplace* are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation's most advanced life insurance professionals.